

WEEKLY COMMENTARY

Is the BoC About to Catch a Falling Knife?

By Royce Mendes, Managing Director and Head of Macro Strategy

Central bankers are taking heat for being reactive rather than proactive in their approach to policymaking. The Bank of Canada (BoC) is no exception. The institution has been behind the curve in adjusting to changing macroeconomic conditions from the get-go. In early 2020, Governing Council took two weeks longer than its peers to respond forcefully to the worst deterioration in economic activity since the Great Depression. Later, even though financial markets were stabilizing and the economy was well on its way to recovery, the BoC’s quantitative easing program continued to gobble up sovereign bonds in an otiose attempt to add stimulus. Now, with inflation sky high, Canada’s central bank is tightening policy at a faster pace than any of its peers in terms of rate hikes and shedding assets from its balance sheet. So playing catch-up is nothing new for the BoC. But being behind the curve is a dangerous spot for monetary policymakers.

The technocrats working out of 234 Wellington Street in Ottawa are supposed to be firmly forward-looking when making monetary policy decisions. The BoC’s website and publications are littered with quotes about policy working with a lag and so needing to be based on “where inflation is likely to be in the future, not what it is today.” No one will fault policymakers for not having forecast a pandemic. But the delayed reactions in first providing stimulus, then right-sizing it, and then removing it altogether are less defensible errors.

Last week’s Jackson Hole Economic Symposium highlighted just how focused global policymakers are on the current spate of high inflation. But that comes despite both public and private forecasters believing that North American inflation has already peaked and inflation expectations falling back down. Is the BoC about to catch a falling knife by continuing to aggressively raise rates?

Conventional theory assumes that it takes between six to eight quarters for interest rate increases to have their full effect. It’s been less than two quarters since the BoC’s initial 25bp rate increase and barely two months since monetary policymakers shocked markets by hiking rates 100bps. So, even though economic momentum hasn’t fallen off a cliff, there’s been very little time to assess just how much impact higher interest rates are having on the economy.

While there’s a chance that Governor Macklem will only raise rates 50bps, it’s more likely that the BoC will hike rates the 75bps the market has priced in. This means the BoC is clearly at risk of catching a falling knife. That said, the persistence and breadth of inflation has left the economy more vulnerable to a high-inflation mindset becoming entrenched. Solving such a problem would involve much more pain than just the mild recession we have pencilled in. While the Bank of Canada might be cautiously optimistic that inflation is beginning a long journey back to target, it probably doesn’t have a high degree of confidence in that forecast. So, if the central bank is about to catch a falling knife, it might just be because it’s willing to lose a few fingers to save the economy from facing a far harsher punishment.

CONTENT

Musing of the Week	1	What to Watch For	2	Economic Indicators	4
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What to Watch For

By Randall Bartlett, Senior Director of Canadian Economics, Tiago Figueiredo, Associate – Macro Strategy, Marc Desormeaux, Principal Economist, and Francis Généreux, Principal Economist

TUESDAY September 6 - 10:00

August

Consensus	55.0
Desjardins	55.4
July	56.7

WEDNESDAY September 7 - 8:30

July

Consensus	n/a
Desjardins	3.20
June	5.05

WEDNESDAY September 7 - 8:30

September

Consensus	3.25%
Desjardins	3.25%
July 13	2.50%

FRIDAY September 9 - 8:30

August

Consensus	n/a
Desjardins	15,000
July	-30,600

FRIDAY September 9 - 8:30

August

Consensus	n/a
Desjardins	82.9%
July	82.0%

UNITED STATES

Services PMI (August) – After a three-month straight decline from April to June and decreases in six out of seven months, the non-manufacturing PMI surprised everyone with a 1.8 point increase in July. Sitting at 56.7, the Services PMI is in a good position, pointing to continued economic growth in the United States. However, based on the main regional non-manufacturing indexes, we expect it will drop in August. Stronger consumer confidence nevertheless shows there's currently some support for the service sector, leading us to predict the Services PMI will only slip from 56.7 to 55.4.

CANADA

International Merchandise Trade (July) – Canada's goods trade balance is expected to shrink in July to \$3.2 billion from \$5.0 billion in June. The drop in nominal exports is expected to have played a major factor in this decline as prices cooled on lower commodity prices and volumes shrunk on the back of less foreign demand. Nominal imports are likely to have also contracted, albeit by less than exports. The depreciation in the Canadian dollar looks to have provided support to import prices while weaker-than-anticipated growth and falling US exports suggest volumes may have taken a modest step back during the month.

Bank of Canada (September) – Monetary policymakers are set to go from rocketing rates higher to just shooting them higher as central bankers downshift from the 100bp hike in July to a 75bp increase next week. But make no mistake, that's still a gigantic amount of tightening to unleash in one go. Central bankers are trying to 'frontload' their rate increases, although this is likely to be closer to the end of the hiking cycle rather than the beginning. Don't expect the accompanying statement to make any firm commitments about what's to come later this year, as there's still scant evidence that inflation is yet on a sustainable path back down to target.

Labour Force Survey (August) – In June and July, the Canadian economy shed 74,000 jobs and the unemployment rate fell two ticks, according to the Labour Force Survey. That said, it seems like a reversal might have been in order in August. Look for the economy to have added a modest 15,000 jobs and for the unemployment rate to have risen to 5.0% on the back of an increase in the participation rate to more reasonable levels. Such an outcome wouldn't change the overall story being told about the Canadian labour market. It's still unsustainably tight. However, as interest rates climb further and gradually take their toll on the economy, look for a more material rise in the unemployment rate on the horizon.

Industrial Capacity Utilization Rate (Q2) – After holding steady at 82.0% for the past two quarters, we anticipate that the industrial capacity utilization rate edged up to 82.9% in Q2. This view is partly based on the moderate rebound in the monthly manufacturing capacity utilization rate, which has remained range bound since the depths of the downturn in Q2 2020. Mining, quarrying, and oil and gas extraction also showed renewed vigour in the second quarter of this year as higher commodity prices spurred activity. In contrast, capacity utilization in construction is expected to take a step back during the quarter, in line with the weakness observed in residential investment.

THURSDAY September 8 - 8:15

September

Consensus 1.25%


Desjardins 1.00%


July 21 0.50%**OVERSEAS**

European Central Bank meeting (September) – Another hefty rate hike is expected in the eurozone. The European Central Bank (ECB) has lagged in its monetary tightening and inflation continues to rise. In July, the ECB raised its three key interest rates by 50 basis points. We expect rates to continue to rise at the same pace. Alternatively, the ECB may take a similar approach to the Federal Reserve in the United States, with a 75 basis point hike. That said, the ECB faces a much more precarious economic context. An energy crisis is hitting the European economy hard and now threatens to push several countries into a recession.

Economic Indicators

Week of September 5 to 9, 2022

Date	Time	Indicator	Period	Consensus		Previous data
UNITED STATES						
MONDAY 5						
	---	Markets closed (Labor Day)				
TUESDAY 6						
	10:00	ISM services index	Aug.	55.0	55.4	56.7
WEDNESDAY 7						
	8:30	Trade balance – Goods and services (US\$B)	July	-70.3	-70.3	-79.6
	9:00	Speech of the Federal Reserve Bank of Richmond President, T. Barkin				
	10:00	Speech of the Federal Reserve Bank of Cleveland President, L. Mester				
	12:35	Speech of a Federal Reserve Governor, L. Brainard				
	14:00	Release of the <i>Beige Book</i>				
THURSDAY 8						
	8:30	Initial unemployment claims	Aug. 29-Sept. 2	240,000	235,000	232,000
	9:10	Speech of the Federal Reserve Chair, J. Powell				
	15:00	Consumer credit (US\$B)	July	33.000	20.000	40.154
FRIDAY 9						
	10:00	Wholesale inventories – final (m/m)	July	0.8%	0.8%	0.8%
	10:00	Speech of the Federal Reserve Bank of Chicago President, C. Evans				
	12:00	Speech of a Federal Reserve Governor, C. Waller				
	12:00	Speech of the Federal Reserve Bank of Kansas City President, E. George				
CANADA						
MONDAY 5						
	---	Markets closed (Labor Day)				
TUESDAY 6						
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WEDNESDAY 7						
	8:30	International trade (\$B)	July	n/a	3.20	5.05
	10:00	Bank of Canada meeting	Sept.	3.25%	3.25%	2.50%
THURSDAY 8						
	11:40	Speech of the Bank of Canada Senior Deputy Governor, C. Rogers				
FRIDAY 9						
	8:30	Net change in employment	Aug.	n/a	15,000	-30,600
	8:30	Unemployment rate	Aug.	n/a	5.0%	4.9%
	8:30	Industrial capacity utilization rate	Q2	n/a	82.9%	82.0%

Note: Desjardins, Economic Studies are involved every week in the Bloomberg survey for Canada and the United States. Approximately 15 economists are consulted for the Canadian survey and a hundred or so for the United States. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. Following the quarter, the abbreviations f, s and t correspond to first estimate, second estimate and third estimate respectively. The times shown are Eastern Standard Time (GMT - 4 hours).  Forecast of Desjardins, Economic Studies of the Desjardins Group.

Economic Indicators

Week of September 5 to 9, 2022

Country	Time	Indicator	Period	Consensus		Previous data		
				m/m (q/q)	y/y	m/m (q/q)	y/y	
OVERSEAS								
DURING THE WEEK								
China	---	Trade balance (US\$B)	Aug.	91.70		101.26		
SUNDAY 4								
Japan	20:30	PMI composite index – final	Aug.	n/a		48.9		
Japan	20:30	PMI services index – final	Aug.	n/a		49.2		
MONDAY 5								
Italy	3:45	PMI composite index	Aug.	48.0		47.7		
Italy	3:45	PMI services index	Aug.	48.8		48.8		
France	3:50	PMI composite index – final	Aug.	49.8		49.8		
France	3:50	PMI services index – final	Aug.	51.0		51.0		
Germany	3:55	PMI composite index – final	Aug.	47.6		47.6		
Germany	3:55	PMI services index – final	Aug.	48.2		48.2		
Euro zone	4:00	PMI composite index – final	Aug.	49.2		49.2		
Euro zone	4:00	PMI services index – final	Aug.	50.2		50.2		
United Kingdom	4:30	PMI composite index – final	Aug.	50.9		50.9		
United Kingdom	4:30	PMI services index – final	Aug.	52.5		52.5		
Euro zone	5:00	Retail sales	July	0.4%	-0.8%	-1.2%		-3.7%
TUESDAY 6								
Australia	0:30	Reserve Bank of Australia meeting	Sept.	2.35%		1.85%		
Germany	2:00	Factory orders	July	-0.6%	-13.4%	-0.4%		-9.0%
United Kingdom	4:30	PMI construction index	Aug.	48.0		48.9		
WEDNESDAY 7								
Japan	1:00	Leading indicator – preliminary	July	100.2		100.9		
Japan	1:00	Coincident indicator – preliminary	July	100.0		98.6		
Germany	2:00	Industrial production	July	-0.6%	-2.1%	0.4%		-0.5%
Italy	4:00	Retail sales	July	0.3%	n/a	-1.1%		1.4%
Euro zone	5:00	Net change in employment – final	Q2	n/a	n/a	0.3%		2.4%
Euro zone	5:00	Real GDP – final	Q2	0.6%	3.9%	0.6%		3.9%
Japan	19:50	Current account (¥B)	July	19.9		838.3		
Japan	19:50	Real GDP – final	Q2	0.7%		0.5%		
THURSDAY 8								
France	2:45	Trade balance (€M)	July	-12,980		-13,066		
France	2:45	Current account (€B)	July	n/a		-1.6		
France	2:45	Industrial production	July	-0.5%	-0.1%	1.4%		1.4%
Euro zone	8:15	European Central Bank meeting	Sept.	1.25%		0.50%		
China	21:30	Consumer price index	Aug.		2.8%			2.7%
China	21:30	Producer price index	Aug.		3.2%			4.2%
FRIDAY 9								
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Note: In contrast to the situation in Canada and the United States, disclosure of overseas economic figures is much more approximate. The day of publication is therefore shown for information purposes only. The abbreviations m/m, q/q and y/y correspond to monthly, quarterly and yearly variation respectively. The times shown are Eastern Standard Time (GMT - 4 hours).